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SUBJECT: HOUSING MARKET GREEN SHOOTS COULD SUFFER "RENEWED  
RECESSIONARY FROST"

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¶1. (SBU) Summary: The UK is beginning to see positive signs in the housing market, but recovery is fragile and in its early stages. Adrian Coles, director-general of the Building Societies Association (BSA), told us a microscope is necessary to see the green shoots, but house prices may be bottoming out. Surveyors are recording increased buyer inquiries, share prices of house building companies are up, and mortgage lending is starting to strengthen, although it remains much weaker than a year ago. Coles is skeptical HMG's multitude of initiatives, designed to assist a house market recovery, are having a significant impact and thinks the UK may have to just ride out the recession and the accompanying house price correction. End Summary.

#### Housing Demand Returning - But Problems Ahead

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¶2. (U) The UK housing market is showing signs of bottoming out, though industry experts hesitate to declare the start of a sustained recovery. Nationwide Building Society's house price index for March showed a surprising uptick, with an increase of 0.9 percent. Industry website Rightmove announced vendors are setting prices 1.8 percent higher in April than March. According to the company, property asking prices increased three months in a row. Miles Shipside, commercial director of Rightmove, said: "My view is that many sellers are still starting too high, but the fact they are coming to market in greater numbers and feel they can ask more shows a strengthening in resolve and confidence, which is an encouraging sign."

¶3. (SBU) Housing demand is slowly returning because of perceived affordability, according to Coles of the BSA. He told us first-time buyers are beginning to think it is a good time to enter the market, with prices having fallen significantly over the past year. However, he cautioned that this renewed demand will be undermined over the next year by volatility in the job market. With unemployment set to reach at least three million by the end of the year, Coles warned the fragile housing market recovery could succumb to a "renewed recessionary frost" as demand slips away and people face layoffs and difficulty returning to the job market. Job security, he said, is likely to remain the biggest obstacle to increased demand.

#### Mortgage Supply Improving But Still Weak

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¶4. (SBU) While mortgage supply is improving, it is still well below normal levels and is insufficient to meet pent-up demand, according to Coles. Figures from the Council of Mortgage Lenders (CML) showed a 4 percent increase in mortgages approved in January and February, yet the total of 24,300 was 46 percent below the same period last

year. There were 9,400 loans to first-time buyers - a 7 percent monthly increase - but significantly less than the 17,400 in February 2008. Coles noted the mortgage market that will emerge from the downturn will be dramatically different from the market at its peak in 2007. High loan-to-value (LTV) mortgages have disappeared from the market. First-time buyers had an average deposit of 25 percent in February, up from 11 percent the same time last year, a new record according to CML figures. Coles said higher LTV mortgages are available but come with strings attached and are geared towards wealthier borrowers. Mortgage supply is strongest in the sub-60 percent LTV range.

15. (SBU) Coles was optimistic credit availability is likely to improve over the next quarter (Reftel A). Both Royal Bank of Scotland (RBS) and Lloyds Banking Group made mortgage lending commitments when they entered into HMG's Asset Protection Scheme (GBP 9 billion and GBP 3 billion respectively) and Northern Rock, Barclays and HSBC have all announced self-imposed higher lending targets. However, Coles cautioned this lending is just a drop in the ocean compared to how far lending levels have declined. Mortgage supply is unlikely to return to pre-recession levels in the near term because of significant risk aversion amongst lenders, which will worsen if arrears and repossessions increase as expected. Coles added that wholesale capital markets are still effectively closed and the flow of retail deposits is stifled.

#### Government Initiatives Not Helping

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16. (SBU) The UK Government announced a number of schemes to help homeowners during its 2009 Budget released April 22 (Reftel B). However, Coles is dubious about how effective these schemes will be given current market conditions. He said the guarantee for mortgage-backed securities will not achieve a great amount. It will just increase the amount of government-backed paper. He said

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government guarantees lose value as the number of guarantees increase. He was equally pessimistic about the extended stamp duty (tax on home purchases) holiday for purchases under GBP 175,000 (\$254,000). He said stamp duty is not one of the biggest impediments to home purchases, so an extended holiday is unlikely to achieve increased demand. He warned that lenders are facing conflicting pressures from the Financial Services Authority (FSA) and HMG - with the FSA urging lenders to be extremely cautious while HMG is pushing for increased lending to stimulate the market. He concluded that the UK is experiencing a hangover from an extraordinary housing price boom and will need to ride out the inevitable period of correction. As such, there is a limit to what government initiatives will achieve.

TOKOLA